

attributable to the carriage of the programming produced by the multichannel distributor.⁵⁰ If, in the absence of in-house programming the distributor would not find the service profitable to carry, then it is only slightly more likely that the distributor would carry the service with the distributor-produced programming.

The fact that the distributor might have an ownership interest in the program service itself does not alter the analysis. Such distributors will typically produce only a fraction of the programming appearing on their own programming services. Moreover, any favoritism in these circumstances may be even less likely since such favoritism -- replacing a more profitable program with a less profitable in-house program -- would directly harm the distributor.⁵¹ To paraphrase one study, the goal of these distributors is to make profits, not programs. If a distributor "can produce in-house at lower cost a program that is as valuable as a program available from an independent supplier, it will undoubtedly do so. But the reverse is equally true."⁵²

⁵⁰To be sure, some cable operators have extensive program production arms, but with few exceptions, these entities target their output to movies or broadcast television, not to cable programming services.

⁵¹If a cable programming service possessed proprietary resources (private information, for example) that could affect the "after-cable" value of individual programs and if these resources were difficult to price, the programming service may favor its own services with these resources. However, if the "after-cable" value of a program were an important source of revenue to the independent producers, we would expect these producers to express a willingness to sell the service an ownership interest in the program.

⁵²S.M. Besen, T.G. Krattenmaker, A.R. Metzger, and J.R. Woodbury, Misregulating Television: Network Dominance and the FCC, Chicago: University of Chicago Press, 1984, p. 155.

More generally, the fact that most programs appearing on cable programming services are produced by entities that are independently owned suggests that the most efficient form of organization of program production often is a highly decentralized system. This organizational form is not unique to cable programming. Even when in-house production by the broadcast networks was not restricted by consent decrees, their participation in the production of entertainment programs was quite limited.⁵³ For example, in the early 1970s, CBS and NBC frequently appeared among the top twenty suppliers of prime time series, but accounted for less than 4 percent of total prime time programming hours.

In sum, this analysis suggests that (1) independent program production is likely the most efficient form of organizing program supply and (2) that because the incidence of in-house production is so rare, the possibility of consumer harm is very remote. One immediate implication is that in those circumstances in which in-house production of cable programming services does occur, the reason is very likely to be cost-based.⁵⁴ For example, distributors have substantial experience in predicting subscriber and advertiser preferences which they can take advantage of if they engage in program production themselves. In addition, there may be

⁵³One exception to this pattern reinforces the similarity between cable and broadcast program production. Broadcast networks and stations typically are heavily involved in the production of news, sports, and weather programming. Many of the cases where cable program services use in-house production also involve this programming.

⁵⁴See ibid., pp. 154-156, for an analysis of "in-house production" by the broadcast television networks.

substantial "moral hazard" problems when programs are provided by independent producers that can be ameliorated somewhat when distributors produce their own programs. If program producers are simply compensated for the costs of program production, they may not expend their best efforts in production.

A distributor could attempt to deal with the first of these problems by providing information directly to independent program producers, although those producers could then use that information in supplying programs to rival or non-competing distributors.⁵⁵ Put differently, the distributor would be unable to capture the full benefits of this information if it simply gave the information away. Selling the information to producers may be equally problematic, because it may be difficult to communicate the information to the independent producer. But even if the distributor were willing to give the information away, the independent producer may have to incur substantial costs to evaluate the veracity of the information.

The moral hazard problem could be dealt with by linking the producer's compensation with the performance of the programming, by significant involvement of the distributor in program production, or by taking advantage of the "repeated play" nature of the relationship between program producers and distributors, although these will often be imperfect solutions.

⁵⁵Examples of rival distributors are Direct Broadcast Satellite or Multichannel Multipoint Distribution Services in the same geographic area. Non-competing distributors are those in other geographic markets.

The relative rarity of in-house production suggests that it will only be undertaken when the problems of informational transfer or moral hazard are particularly acute.⁵⁶ Because both the actual and potential competitive threat is small, and there are potential efficiency gains, there is no reason to limit the participation by multichannel distributors in program production. For these reasons, we concur in the Commission's tentative judgment not to impose any limits.

V. Anti-Trafficking

The Cable Act of 1992 restricts the ability of cable operators to transfer control of their systems. In particular, the Act imposes, with certain exceptions, a three year holding period after the acquisition of a system before a transfer can occur. These "anti-trafficking" proscriptions are intended to prevent transactions that are "engaged in for purposes of profiteering or to affect cable rates or service."⁵⁷ The Notice requests comments on how to define transfers of control, and on how broadly or narrowly to interpret the various statutory exceptions.

To begin with, it is important to observe that restrictions on ownership transfers are unusual in the American economy, largely because market transfers promote economic efficiency by moving assets from lower- to higher-valued uses. Indeed, many writers

⁵⁶The gains may be even larger if independent producers realize that they must compete against the potential in-house alternative.

⁵⁷Notice, para. 12.

have been concerned with impediments that prevent such transactions from occurring, with the result that the values of many assets are not maximized.

Two concerns appear to have led to the adoption of the anti-trafficking rules. First, there is the fear that some entities have, in the past, competed for cable television franchises not in order to operate a cable system but only to resell the franchise quickly after it is awarded to them. Second, the view has been expressed that cable systems that are acquired at high prices are, as a result, forced to raise their rates to consumers.

With these concerns in mind, it can be observed that the anti-trafficking rules do not deal directly with the second of them because the rules do not limit the prices that can be charged for cable systems. Unless there is some nexus between the prices that are charged for cable systems and the frequency with which they are exchanged, the rule would seem to have little effect on prices paid by subscribers.

Moreover, there is an even more fundamental flaw in the reasoning that links cable system sale prices and subscriber rates. The flaw is that the reasoning confuses cause and effect. Cable systems sell at the prices they do because of the rates that the buyer expects to be able to charge to consumers. Put differently, the price that the owner of a cable system wishes to charge to subscribers is unaffected by the price that the owner paid for it. The anti-trafficking rules would thus not seem to be a good route through which to deal with concerns about subscriber rates.

With regard to the issue of seeking cable franchises in order to resell them, it is undeniable that such behavior has occurred. Indeed, such behavior was encouraged by the manner in which franchises were initially awarded, where the "winning bidder" for the franchise was not necessarily the one that would operate the system most efficiently, and therefore most profitably. Thus, in these instances, resale of the franchise is profitable to the winning bidder. Only a system in which franchises are awarded by auction to the highest bidder would prevent such behavior.

There are two reasons why the anti-trafficking rule are not responsive to this concern. First, most franchises have already been awarded, so that the "rent seeking" behavior that the rule is designed to deal with is largely a thing of the past. Second, and more fundamentally, the way to have dealt with this form of behavior would have been to change the method of awarding the franchise. Although preventing rapid resale of a franchise after it was awarded might have led to the exclusion of some bidders, it equally might have resulted in awards to more patient "rent seekers," i.e., ones with a lower discount rate. If the latter is the case, the effect of the anti-trafficking rule would merely be to extend the period over which the cable system is operated at less than maximum efficiency.

The Congress nonetheless has adopted an anti-trafficking rule that the Commission must implement. What the previous discussion implies, however, is that the Commission should interpret the rule liberally. For example, the Commission should invoke the required

holding period in the least restrictive manner possible. The Commission should not restrict the immediate resale of some systems that are part of a larger transaction. The standards for transfer of control should be clear. And the procedures for obtaining approval for transfers should be streamlined.